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The Railroad Week in Review 2/3/2001

Shareholders of Wisconsin Central (Nasdaq: WCLX) could hardly have been terribly surprised by the proposed sale to Canadian National (NYSE: CNI). It's an excellent geographic fit, both roads are scheduled operations doing a lot of paper business, and are sensitive to customer satisfaction issues.

The offer is for $17.50 per share or $812 mm plus $400 mm in debt and represents a 25% premium over the 200-day moving average stock price of about $14. By way of comparison, both roads sell at about 1.6 times book and twice sales. Both have consistently posted double-digit profit margins and can claim operating ratios among the lowest in the land.

Over the past year, CNI has been the more consistent winner in the stock price sweeps and both have been top performers in the group in the past 12 months. CNI in its analysts' conference last week touted the 24-hour chop in Vancounver-Chicago transit times, and that via a route owned by WCLX. Says CNI's Paul Tellier, "Single-line service over this link under CN ownership will improve the competitiveness of CN/WC and their customers in Canada-United States trade, which is growing annually at more than 10 per cent."

Elsewhere CNI says it anticipates $60 mm in savings by Year Three, to which Morgan Stanley Dean Witter analyst Jim Valentine adds that level of savings could push the WCLX operating ratio into the 50s. At that rate the value of the merger could be accretive to CNI earnings in 2002. The assumption is that this will be a "minor transaction" in the STB's eyes because a class 1 road (CNI) is acquiring a class 2 road (WCLX). If it does not, and opts to call it a major deal, that could add a year or more to the process, and it's doubtful CNI would stay interested.

It is anticipated WCLX will sell its overseas equity investments without delay. New Zealand and Tasmania should be done before the larger deal is done in October. Disposing of EWS may take longer, however. CN expects WCTC to carry out its commitment to sell its minority equity investments in overseas rail ventures as soon as possible. The sale process for WC's 42.5% equity interest in Britain's EWS may take longer, as it will be guided by the progress of that firm's new management in improving the railroad's operating and financial performance.

In the midst of all this Wisconsin Central posted results for the quarter and full year 2000. In 4Q00 net income was a record $10.6 mm or 23 cents a diluted share after one-time hits including the $1.1 mm for the proxy fight. Last year in 4Q99 earnings were 36 cents a share; excluding the special charges, 4Q00 would have been 29 cents. For the year, net income was $45.6 mm ($.93 per diluted common share) vs. $1.35 a year ago. Excluding special items, net income would have been $1.16 per diluted common share.

CEO Tom Power said higher fuel costs took six cents off the quarterly per share results and 21 cents off the annual number. The softening North American Economy pushed car counts down 8% YTY yet revenues were off a mere point, reflecting a higher yield mix and sharper pricing. In fact, sales for the year hit a record $372 mm. The full-year OR was 74.5 percent.

Income from affiliates declined yet again to $2.4 mm from $3.7 mm YTY excluding the $1.1 mm special charge at TranzRail. EWS revenues were off a point while its operating expenses went up two points. EWS lost most in 4Q due in part to the infrastructure problems reported here in Dec. The TranzRail contribution was actually a positive half-million US dollars before the charge.

The bottom line is that CNI is buying one terrific North American Railroad. At the analyst conference last week Hunter Harrison talked about the importance of the "blocking and tackling" aspects of basic railroading. WIR readers will recall WC's Reilly McCarren writing about how they do the same. This bespeaks a common culture between acquirer and acquiree, and we've all seen what can happen when that is missing.

Continuing our thread of shortlines operating smarter, recent field trips bore some quite good news. A shortline and a class 1 are collaborating on unit feed grain trains running through ***with power*** to shortline destinations stopping only at the interchange to swap crews. Shows what can be done with some imagination and commitments to communication.

The run-through cut shortline cycle time by two days per unit per trip. Units in question are made up of both railroad-owned and leased equipment and cycle every two weeks. Taking two days out of the cycle time effectively adds 200 car days-per car per year and increases the relative value of the shortline to both the customer and class 1.

Norfolk Southern (NYSE: NSC) realigning the operating divisions in its central sector service region. In so doing it cuts an entire division out of the organization even as it creates a new Central Division, mostly made up of former Kentucky and Tennessee Division line segments. Terminals in Louisville, Cincinnati and Chattanooga go to the new Central Division. Memphis and Sheffield will be folded into the Alabama Division. Reporting locations for T&E personnel are unchanged.

The Department of Justice has remanded the product and geographic competition case to the STB saying the agency did not consider everything it ought to have. DOJ agreed with the STB that the law doesn't stipulate the STB has to consider these issues when looking into rate reasonableness. But at the same time the Court sided with the AAR citing Stagger's "preference for market-based rather than regulatory rate setting."

The Court writes, "Pursuant to the Congress's market dominance directive… ICC [will] consider only direct competition using the same point of departure and the same destination by other rail carriers. During the rulemaking process, the ICC expressly declined to require consideration of indirect product competition (using a different product subject to a different rate) or geographic competition (using a different departure point or destination)." The full decision is at http://pacer.cadc.uscourts.gov/common/opinions/200101/99-1354a.txt.

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